

**ANALYSIS OF ORIGINAL BILL**

Author: Bogh Analyst: Gail Hall Bill Number: AB 2352

Related Bills: See Legislative History Telephone: 845-6111 Introduced Date: February 23, 2006

Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Employee Benefits Paid to Employees Who Are On Active Duty Or Service With California National Guard or United States Military Reserve Credit

**SUMMARY**

This bill would allow a tax credit for amounts paid to or on behalf of a qualified employee who is on active duty or service.

**PURPOSE OF THE BILL**

According to the author's staff, the purpose of the bill is to encourage employers to pay the difference between their employee's military pay and the employee's usual wage. The difference in pay will allow an employee, who earns less with their military pay, to continue to provide the same standard of living for their families while on active duty.

**EFFECTIVE/OPERATIVE DATE**

This bill is a tax levy and would be effective upon enactment, and would specifically apply to taxable years beginning on or after January 1, 2007.

**POSITION**

Pending.

**ANALYSIS**FEDERAL/STATE LAW

The Uniformed Services Employment and Reemployment Rights Act (USERRA) of 1994 guarantees the rights of military service members to take a leave of absence from their civilian jobs for active military service. The guaranteed rights include an unpaid leave of absence for a period not to exceed five years to perform any form of military service. This act does not require employers to pay the difference between their employee's military pay and the employee's usual wage. USERRA applies to all employers, regardless of size, in every state.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Selvi Stanislaus

4/24/06

## **THIS BILL**

This bill would allow a 100% credit for the amount of qualified benefits paid to or on behalf of a qualified employee. "Qualified benefits" would be defined as amounts paid to or on behalf of a qualified employee that do not exceed the difference between the amount of his or her military pay and allowances and the amount that would have been received as an employee. "Qualified employee" would be defined as any member of the California National Guard or reserve component of the Armed Forces of the United States (U.S) who is called to active duty or service.

Any excess credit could be carried over until exhausted.

## **IMPLEMENTATION CONSIDERATIONS**

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

1. This bill does not limit the number of years the credit may be carried over to future years. The department would be required to retain the carryover on the tax forms indefinitely because unlimited credit carryover is allowed. Recent credits have been enacted with a carryover period limitation because experience shows credits typically are exhausted within eight years of being earned.
2. The author may wish to further define military pay and allowances. Certain benefits are excluded from gross income but appear on the employee's military paycheck. It may be difficult for employers to know what these items are in order to determine how much should be paid to make up the difference. Also, an employer may provide health, dental, retirement, or cafeteria plan payments for their employee. It is not clear if the employer would have to consider these types of payments to calculate the differences in pay. While it appears the bill's intent is to make up the difference in salary regardless of what items are taxable, further clarification will be helpful for the employer and the Franchise Tax Board.

## **TECHNICAL CONSIDERATIONS**

The author may wish to describe the U.S. military reserves as a "reserve component of the armed forces of the United States" instead of "United States Military Reserve organization" for consistency. The Revenue and Taxation Code (R&TC) currently describes the U.S. military reserves as a "reserve component"<sup>1</sup>. (See attached Amendment 1.)

## **LEGISLATIVE HISTORY**

AB 1862 (Wyman, 2001/2002) and SB 1776 (Poochigian, 2001/2002) would have provided a credit, similar to this bill, for the difference between an employee's military pay and an employee's usual pay. AB 1862 was held in the Assembly Committee on Revenue and Taxation, and SB 1776 was held in the Senate Committee on Revenue and Taxation.

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<sup>1</sup> R&TC Section 17022.

AB 3240 (Conroy, 1995/1996) would have allowed an employer a \$500 tax credit for each employee who was a member of any military reserve or the National Guard and was assigned to active duty to meet an emergency as a result of military orders. AB 3240 failed passage in the Senate Committee on Revenue and Taxation.

## OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws. Research found that these states do not provide an employer tax credit similar to this bill.

## FISCAL IMPACT

This bill would not significantly impact the department's costs because the changes required by this bill could be accomplished during the department's annual update.

## ECONOMIC IMPACT

### Revenue Estimate

The estimated revenue losses from this bill are as follows:

<b>Estimated Revenue Impact of AB 2352</b>		
Effective Tax Years BOA 1/1/2007		
Assumed Enactment Date After 6/30/06		
<b>(Millions)</b>		
<b>2005-06</b>	<b>2006-07</b>	<b>2007-08</b>
-\$0	-\$10	-\$45

This analysis does not consider the possible changes in investment activity, employment, personal income, or gross state product that could result from this measure.

### Revenue Discussion

The impact of this bill would depend upon: (1) the number of businesses incurring expenses for qualified benefits paid to employees who are called up to active military duty and are on active duty during the taxable year, and (2) the average credit applied against tax liabilities.

This estimate assumes that the author's intent was that a "qualified employee" be a resident of California.

Based on the actual number of reservists and National Guard called to active duty to date in California, it is estimated that approximately 6,500 personnel years of reservists and National Guard would be called and used for active duty in 2006. It is assumed that this number will remain constant for the foreseeable future. If this number increases or decreases, the revenue impact would increase or decrease, respectively. For purposes of this analysis, it was estimated the average annual salary is \$51,000 and military pay is 50% of that for a potential credit of \$166

million (6,500 x \$51,000 x 50%). Of the \$166 million in potential credit, it is projected that only 35% or \$60 million will be claimed annually. The estimates presented in the table above reflect fiscal year revenue losses.

## **ARGUMENTS/POLICY CONCERNS**

1. Credits generally are provided as a percentage of amounts paid or incurred. This bill would allow a 100% credit, which is unprecedented.
2. This bill does not contain a sunset date. Generally, credits contain a sunset date that ensures the Legislature has the opportunity to periodically review its effectiveness.
3. This bill would not benefit self-employed taxpayers who are also called to active duty. A taxpayer who is self-employed will not be able to take a credit on the benefits paid as defined in the bill. Thus, this bill would provide differing treatment based solely on the form of business in which the qualified employee is employed.
4. Conflicting tax policies come into play whenever a credit is provided for an item that is already deductible as a business expense. Providing both a credit (in this case a 100 percent credit) and allowing the full amount to be deducted would have the effect of providing a double benefit for that item. On the other hand, making an adjustment to deny the deduction in order to eliminate the double benefit creates a difference between state and federal taxable income, which is contrary to the state's general federal conformity policy.
5. This credit would not be limited to benefits paid to employees that are employed in California. As a result, the bill would allow a 100% credit to benefits paid by an employer to an employee anywhere. The author may wish to limit the credit to benefits paid to employees employed in California.

## **LEGISLATIVE STAFF CONTACT**

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FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO AB 2352  
As Introduced February 23, 2006

AMENDMENT 1

On page 2, line 7, strikeout "United States Military  
Reserve Organization," and insert:

reserve component of the armed forces of the United States,